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No. 05-996

In the Supreme Court of the United States

ROBERT LOUIS MARRAMA, PETITIONER

v.

CITIZENS BANK OF MASSACHUSETTS, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENTS

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QUESTION PRESENTED

Whether 11 U.S.C. 706(a) deprives a bankruptcy court of its inherent power to sanction and deter bad faith conduct by denying a debtor's request to convert a chapter 7 bankruptcy case to chapter 13.

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INTEREST OF THE UNITED STATES

The courts below found that petitioner, a debtor in bankruptcy, had made false declarations about his assets and financial affairs in furtherance of a scheme to place his assets beyond the reach of his creditors. Because of petitioner's bad faith conduct, the courts below did not allow petitioner to convert his chapter 7 case to chapter 13. Whether courts may act to deter and sanction a debtor's bad faith conduct in that manner is an issue of substantial importance to the United States.

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees in regions comprising the vast majority of the federal judicial districts. 28 U.S.C. 581-589a. United States Trustees "serve as bankruptcy watch-

dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 595, 95th Cong., 1st Sess. 88 (1977). The United States Trustee Program thus "acts in the public interest to promote the efficiency and to protect and preserve the integrity of the bankruptcy system." U.S. Dep't of Justice, *United States Trustee Program Strategic Plan FY 2005-2010*, at 2 (visited Sept. 28, 2006) <http://www.usdoj.gov/ust/eo/ust_org/StrategicPlanFY2005-2010.pdf>. By statute, "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this Title." 11 U.S.C. 307.

In addition, the United States is the largest creditor in the Nation, and numerous federal agencies, including the Department of Housing and Urban Development, the Commerce Department's Economic Development Administration, the Small Business Administration, the Internal Revenue Service, and the Federal Deposit Insurance Corporation, frequently appear as creditors in chapter 7 proceedings. Because a bankruptcy estate's assets are typically scarce, the United States has an interest in preventing and deterring chapter 7 debtors from concealing assets that should be turned over to satisfy claims of the United States.

STATEMENT

1. a. A debtor commences a voluntary bankruptcy case by filing a petition in bankruptcy court. 11 U.S.C. 301. Four chapters—7, 11, 12, and 13—are potentially available to an individual debtor, and the debtor is required to elect one by checking the appropriate box on the petition. Fed. R. Bankr. P. Official Form 1.

Within 15 days after filing the petition, the debtor must file under penalty of perjury a schedule of assets

and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs. 11 U.S.C. 521(1); Fed. R. Bankr. P. 1007(c); Official Form 6 (Schedules), Form 7 (Statement of Financial Affairs)).

b. Individual debtors typically file for relief under chapter 7 or chapter 13. Chapter 7 provides for a liquidation of a debtor's assets in exchange for a discharge of debts. 11 U.S.C. 701-727. Commencement of a chapter 7 case creates an "estate" that includes all of the debtor's interests in property as of the commencement of the case. 11 U.S.C. 541(a). The debtor must surrender all non-exempt estate property to the chapter 7 trustee, who takes custody of estate property, liquidates it, and disburses the proceeds to creditors in accordance with their rights and priorities under the Bankruptcy Code. 11 U.S.C. 507, 521(3) and (4), 704(1), 726.

A chapter 7 debtor is entitled to a discharge of his pre-petition debts unless the debtor is ineligible or the debts are of a type excepted from discharge by the Code. 11 U.S.C. 523, 727(a) and (b). Courts have the authority, however, to dismiss a chapter 7 case "for cause." 11 U.S.C. 707(a). Similarly, notwithstanding disbursement of estate assets to creditors, courts may deny a chapter 7 discharge altogether in specified circumstances, including when the debtor has committed acts of concealment or fraud. 11 U.S.C. 727(a)(2)-(6).

Chapter 13 provides for the adjustment of debts of an individual with regular income. 11 U.S.C. 1301-1330. In contrast to chapter 7, a chapter 13 debtor remains in possession of estate assets and receives a discharge of his debts only after he pays his creditors under a plan confirmed by the court. 11 U.S.C. 1304, 1306(b), 1321-1328.

c. Debtors may convert their cases from one chapter to another. 11 U.S.C. 706(a), 1112(a), 1208(a), 1307(a). As relevant here, Section 706(a) provides that "[t]he debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title." The Code also authorizes a court in a proceeding under chapter 13 to dismiss the case or convert it to a chapter 7 case "for cause." 11 U.S.C. 1307(c).

2. On March 11, 2003, petitioner filed a voluntary bankruptcy petition under chapter 7. In petitioner's schedules of assets, petitioner declared, under penalty of perjury, that (a) his Gloucester, Massachusetts, residence was the only real property interest he held; (b) he was the 100% beneficiary of Bo-Mar Realty Trust, a spendthrift trust that held real property in Maine; (c) the current market value of his interest in the trust was zero; and (d) the Internal Revenue Service (IRS) owed him no tax refunds. Pet. App. 10, 30.

Respondent Mark G. DeGiacomo is the chapter 7 trustee appointed in petitioner's case. Based on the trustee's investigation of petitioner's financial affairs (see 11 U.S.C. 704(4)), the trustee concluded that petitioner had failed to disclose two estate assets in his schedules and statement of financial affairs. First, petitioner had not disclosed that he, within one year before filing his chapter 7 petition, transferred residential real estate in York, Maine, having an unencumbered value of $85,000 to the Bo-Mar Realty Trust for no consideration and designated himself sole beneficiary and his girlfriend sole trustee. J.A. 29a-31a; Pet. App. 12, 30. Petitioner's acknowledged intent in that transaction was to protect the property from the claims of his creditors. *Id.* at 30. Second, petitioner had failed to disclose that

in July 2002, he had filed an amended tax return that sought a tax refund from the IRS. *Id.* at 26-27, 30; J.A. 30a-31a. The chapter 7 trustee subsequently informed petitioner that the trustee would seek to avoid the transfer of the Maine property to the trust as a fraudulent conveyance. Pet. App. 14; J.A. 30a; see 11 U.S.C. 548. Thereafter, petitioner filed a notice under Section 706(a) seeking to convert his case to chapter 13. J.A. 11a.

The chapter 7 trustee opposed the conversion on the ground that petitioner had acted in bad faith by intentionally failing to disclose his requested federal tax refund and his transfer of the Maine property to the trust seven months before his chapter 7 petition. Pet. App. 30-31; J.A. 13a-18a. Respondent Citizens Bank of Massachusetts, a secured creditor, also opposed conversion on the ground that the debtor had acted in bad faith. Pet. App. 13; J.A. 19a-25a. Petitioner responded that his misstatements and omissions were inadvertent and that he sought to convert his case to chapter 13 because he had acquired additional rental income and gainful employment. Pet. App. 31; J.A. 33a.

3. a. After conducting a hearing on petitioner's request to convert, the bankruptcy court denied conversion on the ground that petitioner's misrepresentation of his financial affairs constituted "bad faith." Pet. App. 15, 31; J.A. 34a-35a; Supp. J.A. 33. The Bankruptcy Appellate Panel of the First Circuit affirmed. *Id.* at 9-28.

b. The First Circuit affirmed. Pet. App. 29-46. After examining the statutory text of Section 706(a), the court concluded that it could "discern no evidence that the Congress intended to override the presumptive power and responsibility of the bankruptcy court to weed out abuses of the bankruptcy process at any stage in the bankruptcy proceedings." *Id.* at 33. The court

also rejected (*id.* at 37-38) petitioner's reliance on the Senate Report accompanying Section 706(a), which states that Section 706(a) gives the debtor "the one-time absolute right of conversion" and reflects the policy "that the debtor should always be given the opportunity to repay his debts." S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978). The court of appeals explained that those statements, when read in context, did not "negate[] nor undermine[] the overarching principle that the bankruptcy courts are duty bound to take all reasonable steps to preclude debtors from abusing or manipulating the bankruptcy process in order to undermine the essential purposes of the Bankruptcy Code." Pet. App. 38.

The court of appeals further observed that "the Code accords the bankruptcy court discretion to reconvert a chapter 13 case to chapter 7 * * * where the debtor has acted in 'bad faith.'" Pet. App. 39; see 11 U.S.C. 1307(c). The court explained that "it would ill serve general policies aimed at promoting the efficient administration of bankruptcy cases to insist that a bankruptcy court—already confronted with clear evidence of a debtor's bad faith—must indulge in the technical formality of converting the chapter 7 case to chapter 13, knowing full well that eventually the case must be reconverted by reason of that same evidence of bad faith." Pet. App. 39. The court also determined that the record "amply supported" the bankruptcy court's finding that petitioner acted in bad faith. *Id.* at 41.

c. While petitioner's appeal of the denial of his conversion motion was pending, the chapter 7 trustee recovered the Maine property from the trust in order to liquidate it for the benefit of petitioner's creditors. *Marrama* v. *DeGiacomo (In re Marrama)*, 316 B.R. 418,

421-422 (B.A.P. 1st Cir. 2004). Furthermore, Citizens Bank of Massachusetts filed a complaint under 11 U.S.C. 727(a)(2) seeking to deny the debtor a discharge on the grounds that petitioner had engaged in pre-bankruptcy transfers to defraud his creditors. The bankruptcy court granted the denial of a discharge. That order was affirmed by the court of appeals, which concluded that petitioner "transferred valuable assets belonging to him, less than a year before he petitioned for bankruptcy protection, with the actual intent to defraud his creditors." *Marrama* v. *Citizens Bank (In re Marrama)*, 445 F.3d 518, 524 (1st Cir. 2006).

SUMMARY OF ARGUMENT

A. Courts have the inherent power to respond to a party's misconduct in litigation by entering sanctions such as dismissal of the lawsuit or an award of attorney's fees. *Chambers* v. *NASCO, Inc.*, 501 U.S. 32 (1991); *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752 (1980); *Link* v. *Wabash R.R.*, 370 U.S. 626 (1962). Similarly, Congress indicated in Section 105(a) of the Bankruptcy Code that bankruptcy courts may "tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. 105(a).

B. Nothing in the text of Section 706(a) strips the bankruptcy court of its inherent authority, reinforced in Section 105(a), to prevent and deter abuses of the bankruptcy system by denying a debtor relief to which he would otherwise be entitled. Section 706(a) provides that the "[t]he debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time" if the case has not been previously converted to chapter 7 under another chapter. 11 U.S.C.

706(a). The statute does not confer an absolute right, and nothing in the statutory text even mentions, much less impairs, the bankruptcy court's inherent discretion to deny relief in the face of a debtor's bad faith—discretion that is explicitly confirmed in Section 105(a).

C. The bankruptcy court's inherent power to deny conversion to chapter 13 is not foreclosed by Section 1307(c), which permits the court to dismiss a chapter 13 case or convert it to chapter 7 for cause (including the debtor's bad faith). To the contrary, that provision only underscores the appropriateness of denying conversion to chapter 13 in circumstances such as this. Congress's express authorization to convert a chapter 13 case into a chapter 7 liquidation indicates that a denial of rights under chapter 13 is a proper sanction for fraud. Section 1307(c) cannot be read to preclude a court from addressing fraud that is evident before the attempted conversion to chapter 13 or to require a conversion just so that the case can be reconverted to chapter 7. Under this Court's precedents, moreover, statutory and procedural sanctions generally do not displace a court's inherent power. *Chambers*, 501 U.S. at 42-51; *Link*, 370 U.S. at 630-632.

It would make little sense for the bankruptcy court to convert a case to chapter 13 under Section 706(a) when the court has already determined that the debtor has acted in bad faith such that his case should not proceed under chapter 13. Nor should a bad faith debtor have a right to convert to chapter 13 so that he may propose a plan under that chapter. The Code nowhere confers such a right, because Section 1307(c) allows the court, "for cause," to dismiss the chapter 13 case or con-

vert it to chapter 7 at any time without any prerequisite that the debtor first be permitted to propose a plan.

D. Section 706(a)'s legislative history does not establish that Congress intended to displace the bankruptcy court's power to sanction bad faith debtors. The Senate Report to Section 706(a) states that the provision confers on the debtor "the one-time absolute right of conversion" so that "the debtor should always be given the opportunity to repay his debts." S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978). The off-hand reference to the debtor's "absolute" right may simply be a recognition of the fact that the right cannot be waived by agreement. The Report did not address the situation in which the right to convert has been forfeited by fraud, and it would be a mistake to assume that Congress intended to immunize fraud on courts and creditors. A Senate Report is not written and should not be read like legislative text, and petitioner's argument shows the hazards of doing so. In any event, the legislative history, when read in context, reflects an intent to confer rights only on an *honest* debtor who intends to "repay his debts." *Ibid.* The statute's history thus does not purport to cabin a court's inherent power to prevent an abuse of process.

E. A bankruptcy court has the discretion to deny conversion when the debtor intentionally misleads the trustee, creditors, or the bankruptcy court as to the debtor's financial affairs. A debtor who comes to the bankruptcy court seeking relief from his debts, but who in bad faith fails to disclose assets that are to be used to pay creditors, commits gross misconduct that threatens both the foundation and the integrity of the bankruptcy process. Because the bankruptcy court found that petitioner's misstatements of his financial affairs were made in bad faith, the court properly denied conversion

in order to sanction the debtor and to prevent further abuse of process.

ARGUMENT

BANKRUPTCY COURTS POSSESS INHERENT POWER TO DENY CONVERSIONS WHEN SOUGHT BY BAD FAITH DEBTORS

A. Bankruptcy Courts Possess The Inherent Power To Sanction Bad Faith Conduct

1. This Court's precedents have "recognized the 'well-acknowledged' inherent power of a court to levy sanctions in response to abusive litigation practices." *Roadway Express, Inc.* v. *Piper*, 447 U.S. 752, 765 (1980) (citing *Link* v. *Wabash R.R.*, 370 U.S. 626, 632 (1962)). "It has long been understood that '[c]ertain implied powers must necessarily result to our Courts of justice from the nature of their institution,' powers 'which cannot be dispensed with in a Court, because they are necessary to the exercise of all others.'" *Chambers* v. *NASCO, Inc.*, 501 U.S. 32, 43 (1991) (quoting *United States* v. *Hudson*, 11 U.S. (7 Cranch) 32, 34 (1812)). "These powers are 'governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.'" *Ibid.* (quoting *Link*, 370 U.S. at 630-631).

"A primary aspect" of a court's inherent powers is "the ability to fashion an appropriate sanction for conduct which abuses the judicial process." *Chambers*, 501 U.S. at 44-45. A court thus confronted with a party's bad faith conduct in seeking judicial relief or in litigating his cause of action has the discretion to respond with a variety of sanctions. This Court has recognized that

"outright dismissal of a law suit * * * is within the court's discretion" and that "the 'less severe sanction' of an assessment of attorney's fees is undoubtedly within a court's inherent power as well." *Id.* at 45 (quoting *Roadway Express, Inc.*, 447 U.S. at 765).

A clear expression of congressional intent is required to displace a court's inherent power to sanction bad faith conduct. *Chambers*, 501 U.S. at 47. Accordingly, although "the exercise of the inherent power of lower federal courts can be limited by statute and rule," this Court will "'not lightly assume that Congress has intended to depart from established principles,' such as the scope of a court's inherent power." *Ibid.* (quoting *Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982)).

2. The Bankruptcy Code, far from displacing the inherent powers of courts, expressly recognizes the bankruptcy court's authority to sanction litigants for abusive litigation practices. The Code states that "[n]o provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or *to prevent an abuse of process*." 11 U.S.C. 105(a) (emphasis added); see 132 Cong. Rec. 28,610 (1986) (statement of Sen. Hatch) (Section 105(a) "allows a bankruptcy court to take any action on its own, or to make any necessary determination to prevent an abuse of process and to help expedite a case in a proper and justified manner"). Thus, it is well established that bankruptcy courts have

the power to sanction parties or counsel for bad faith conduct in bankruptcy proceedings.[1]

To be sure, Section 105(a) does not empower bankruptcy courts to act contrary to other direct commands of the Code. Cf. *Northwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 206 (1988) ("whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"). But it does expressly caution against reading provisions allowing a party to raise an issue as conferring an absolute right that would trump a court's ability to sanction misconduct. More broadly, Section 105(a) reflects Congress's intent not to displace the established power of courts to impose appropriate orders to prevent an abuse of process. Thus, absent an express provision in the Code that limits a court's inherent power, the bankruptcy court retains the discretion to impose appropriate sanctions in response to a litigant's bad faith.

B. The Text Of Section 706(a) Does Not Restrict A Court's Inherent Power To Deny Conversion When Requested By A Bad Faith Debtor

1. Section 706(a) does not expressly address, much less limit, a court's inherent power to sanction bad faith

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[1] See, e.g., *In re Sunshine Jr. Stores, Inc.*, 456 F.3d 1291, 1304-1306 (11th Cir. 2006); *In re DeVille*, 361 F.3d 539, 548-551 (9th Cir. 2004); *In re Rimsat, Ltd.*, 212 F.3d 1039, 1046-1049 (7th Cir. 2000); *Pearson* v. *First N.H. Mortgage Corp.*, 200 F.3d 30, 42 n.7 (1st Cir. 1999); *Weiss* v. *First Citizens Bank & Trust Co. (In re Weiss)*, 111 F.3d 1159, 1171-1172 (4th Cir.), cert. denied, 522 U.S. 950 (1997); *Mapother & Mapother, PSC* v. *Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996); *In re Huckfeldt*, 39 F.3d 829, 832 (8th Cir. 1994); *Citizens Bank & Trust Co.* v. *Case (In re Case)*, 937 F.2d 1014, 1023-1024 (5th Cir. 1991).

conduct by denying relief to which the debtor would otherwise be entitled. Section 706(a) provides:

> The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable.

11 U.S.C. 706(a). As an initial matter, the text is addressed to the *debtor*, and does not refer to the court's powers at all. By providing that "*[t]he debtor may* convert" a chapter 7 case to another chapter, Congress indicated its intent that conversion is to be initiated by the debtor, rather than another party or the court. But the language does not confer an absolute right on the debtor and does not direct the court to convert automatically upon the debtor's request.

In any event, the statutory text, at most, gives rise to a presumptive right of the debtor to a one-time conversion; it does not restrict, either expressly or implicitly, the ability of the court to exercise its inherent power to respond to abusive tactics or bad faith by the debtor. Section 706(a) is best understood as giving the right to raise the issue of conversion, but in keeping with the approach expressed in Section 105(a), such a provision should not be read to prevent courts from "taking any action * * * to prevent an abuse of process." 11 U.S.C. 105(a). Nor does Section 706(a) purport to confer rights on bad faith debtors. The statutory language "contains no intimation that the debtor should be accorded protection against his own willful misconduct, such as an intentional abuse of the bankruptcy process." Pet. App. 36.

Relying on this Court's recognition that "[t]he word 'may' customarily connotes discretion," *Jama* v. *Immigration & Customs Enforcement*, 543 U.S. 335, 346 (2005), petitioner's amicus argues that Section 706(a) vests debtors with unbounded discretion to decide whether to convert, thereby stripping the court of any power to deny relief. National Ass'n of Consumer Bankr. Att'ys (NACBA) Amicus Br. 8-13. The word "may," however, does not remotely rise to the level of a clear indication that Congress intended to restrict a court's inherent power to sanction a party's bad faith conduct by denying statutory relief to which that party would otherwise be entitled. While it is no doubt true that the term "may" suggests discretion, it is equally true that "in a system of laws discretion is rarely without limits." *Martin* v. *Franklin Capital Corp.*, 126 S. Ct. 704, 710 (2005) (quoting *Independent Fed'n of Flight Attendants* v. *Zipes*, 491 U.S. 754, 758 (1989)); see *System Fed'n No. 91* v. *Wright*, 364 U.S. 642, 648 (1961) ("discretion is never without limits"). Considerably more than the mere recognition of a discretionary right would be required to demonstrate that Congress stripped the courts of their inherent authority to deny relief sought in bad faith.[2]

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[2] The example proffered by petitioner's amicus (NACBA Amicus Br. 8) serves only to confirm the implausibility of petitioner's interpretation. A neighbor's statement to another that "You may use my rake at any time" may well "grant[] the other neighbor permission to use the rake at the latter's discretion," *ibid.*, but it does not confer *unlimited* discretion. Surely, for example, the other neighbor is not thereby authorized to grab the rake unceremoniously out of its owner's hands while the latter is raking his yard. Nor is it obvious that the discretion to borrow the rake would survive an intervening misuse of a borrowed shovel.

For similar reasons, petitioner's amicus errs in relying on the fact that Section 706(a) specifies two express preconditions to conversion—(1) absence of a prior conversion and (2) eligibility as a debtor, see 11 U.S.C. 706(d)—but does not expressly impose a good faith requirement. NACBA Amicus Br. 13-16. The *expressio unius* canon has no application to a requirement that a litigant refrain from bad faith, because that requirement is necessarily implicit whenever a party seeks relief from a court. In other words, because "[a]ll courts have inherent power and duty to prevent abuse of their jurisdiction," "Congress does not have to add to each and every statutory subsection and committee comment thereon the proviso, 'subject to bad faith.'" *In re Starkey*, 179 B.R. 687, 693 (Bankr. N.D. Okla. 1995).

2. The court of appeals also correctly concluded that Congress' use of the statutory phrase "at any time" in Section 706(a) refers to *the time frame* in which the debtor may convert; it does not speak to the *circumstances* under which conversion may occur. At most, that phrase confers an absolute right to convert without regard to time frame, not an absolute right to convert no matter what. Thus, "the debtor may seek to convert at any time during the pendency of the bankruptcy case, or in other words, * * * no artificial time constraints should impede an election to convert." Pet. App. 35. But that temporal phrase "hardly equates to the more broad circumstantial permission which Congress could have conferred, for example, by employing a phrase such as 'regardless of the circumstances.'" *Ibid.*; accord *In re Copper*, 426 F.3d 810, 816 (6th Cir. 2005).

Likewise, a court's inherent power to sanction abuse is not affected by the second sentence of Section 706(a),

which provides that "[a]ny waiver of the right to convert a case under this subsection is unenforceable." 11 U.S.C. 706(a). "[I]n context this sentence functions strictly as a consumer protection provision against adhesion contracts, whereby a debtor's creditors might be precluded from attempting to prescribe a waiver of the debtor's right to convert to chapter 13 as a non-negotiable condition of its contractual agreements." Pet. App. 35. There is a difference between waiver and forfeiture, see, *e.g.*, *Kontrick* v. *Ryan*, 540 U.S. 443, 458 n.13 (2004), and an anti-waiver provision does not necessarily preclude a party from forfeiting a right through affirmative misconduct or immunize a party from the court's inherent authority to sanction misconduct.[3]

[3] Petitioner also argues (Br. 26) that conversion cannot be denied on the basis of a debtor's bad faith because the Bankruptcy Rules do not specifically require motions to convert under Section 706(a) to be treated as contested matters under Rule 9014. As the court of appeals observed, however, the Code contemplates that parties in interest may contest at least some factual pre-conditions to conversion, such as "the absence of any prior conversions to chapter 13, and the debtor's ability to meet the eligibility requirements to file a chapter 13 petition in the first instance." Pet. App. 45. Moreover, the Rules provide that a debtor requesting conversion under Section 706(a) must seek that relief by motion. See Fed. R. Bankr. P. 1017(f)(2), 9013. The Rules thus also contemplate that the bankruptcy court will review the matter before ordering relief. In any event, nothing in Rule 9014(c) addresses, much less displaces, a court's inherent power to act, sua sponte or on motion of a party, in the face of a debtor's abuse of the bankruptcy process, nor do the Rules limit the court's ability to hold any hearing that may be necessary in such instances to resolve contested issues of material fact.

C. A Bankruptcy Court's Express Power To Dismiss A Chapter 13 Case Or Convert It To Chapter 7 Does Not Deprive The Court Of Its Inherent Authority To Deny Conversion In The First Instance

1. Section 1307(c) provides that "on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under [chapter 13] to a case under chapter 7 * * * , or may dismiss a case under [chapter 13], whichever is in the best interest of creditors and the estate, for cause." 11 U.S.C. 1307(c). A debtor's bad faith constitutes cause under Section 1307(c).[4] Petitioner and his amicus argue that because Congress empowers a bankruptcy court to respond to a debtor's bad faith by dismissal of the chapter 13 case or by reconversion of the case to chapter 7, Congress left no room under Section 706(a) for courts to deny conversion in the first instance even when the debtor seeks conversion in bad faith or the court is aware of pre-conversion efforts to defraud the court and creditors. Pet. Br. 24; NACBA Amicus Br. 18-20. That contention lacks merit.

The law is clear that "the inherent power of a court can be invoked even if procedural rules exist which sanction the same conduct." *Chambers*, 501 U.S. at 49. Thus, in *Link*, 370 U.S. at 630-632, this Court held that a court had the inherent authority to dismiss a suit sua sponte for lack of prosecution notwithstanding the fact that Federal Rule of Civil Procedure 41(b) appears to

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[4] See, *e.g.*, *Alt* v. *United States (In re Alt)*, 305 F.3d 413, 418-420 (6th Cir. 2002); *In re Lilley*, 91 F.3d 491, 496 (3d Cir. 1996); *Molitor* v. *Eidson (In re Molitor)*, 76 F.3d 218, 220 (8th Cir. 1996); *Eisen* v. *Curry (In re Eisen)*, 14 F.3d 469, 470 (9th Cir. 1994); *In re Love*, 957 F.2d 1350, 1354 (7th Cir. 1992).

require a motion by a party. Similarly, in *Chambers*, 501 U.S. at 42-50, the Court held that a court's inherent power to impose attorney's fees as a sanction was not foreclosed by Federal Rule of Civil Procedure 11 and 28 U.S.C. 1927, which authorize the imposition of attorney's fees as a sanction in specified circumstances. The Court explained that other mechanisms of sanctioning misconduct, either "taken alone or together, are not substitutes for the inherent power," and accordingly that federal courts are not "forbidden to sanction bad-faith conduct by means of the inherent power simply because that conduct could also be sanctioned under the statute or the Rules." *Chambers*, 501 U.S. at 46, 50. Thus, "if in the informed discretion of the court, neither the statute nor [procedural rules] are up to the task, the court may safely rely on its inherent power." *Id.* at 50.

There is no basis for limiting the court's inherent discretion to enter sanctions at the earliest appropriate opportunity, *i.e.*, by denying conversion in the first instance. "[I]t would ill serve general policies aimed at promoting the efficient administration of bankruptcy cases to insist that a bankruptcy court—already confronted with clear evidence of a debtor's bad faith—must indulge in the technical formality of converting the chapter 7 case to chapter 13, knowing full well that eventually the case must be reconverted by reason of that same evidence of bad faith." Pet. App. 39. As the court of appeals of appeals observed, the Code does not require "such pointless spinning of judicial wheels." *Ibid.* Indeed, far from undermining the authority to deny conversion as a sanction for bad faith, Section 1307(c) underscores the appropriateness of requiring chapter 7 liquidation as a sanction. The fact that

Congress expressly contemplated dismissal or conversion of chapter 13 proceedings as a sanction for bad faith conduct should not preclude a court hearing a chapter 7 case from imposing a like sanction for bad faith that precedes an effort to convert to chapter 13.

2. Petitioner and his amicus contend that forcing a court to grant a debtor's motion to convert, even in the face of fraud on the court or other egregious misconduct by the debtor, would serve the purpose of giving the debtor an opportunity to propose a repayment plan under 11 U.S.C. 1322. Pet. Br. 22-26; NACBA Amicus Br. 18-20, 23-24. In a similar vein, petitioner's amicus observes that the bankruptcy court cannot confirm a chapter 13 plan unless unsecured creditors will receive at least as much as they would under chapter 7. *Id.* at 19-20 (citing 11 U.S.C. 1325(a)(4), 1328(b)(2)). Amicus argues that those provisions, along with the power of the chapter 13 trustee to investigate the debtor's financial affairs, "provide[] powerful assurance that a debtor cannot convert a case to chapter 13 in order to evade his creditors." *Id.* at 19. Those contentions are flawed in several fundamental respects.

Section 1307(c) contains no requirement that a bankruptcy court must wait for a debtor to propose a repayment plan before the court can exercise its statutory power to dismiss or reconvert the case to chapter 7 upon a finding of a debtor's bad faith. The notion that bankruptcy courts cannot act under Section 1307(c) without a prior proposal by the debtor of a plan also conflicts with Section 105(a), which permits a court to raise, on its own motion, the issue of dismissal or conversion to prevent an abuse of process. 11 U.S.C. 105(a) ("No provision of this title providing for the raising of an issue by

a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate * * * to prevent an abuse of process.") (emphasis added).

The bankruptcy court's dismissal and conversion power under Section 1307(c), moreover, defeats the suggestion that Congress intended to confer on a bad faith debtor the right to propose a plan under chapter 13. And there is "neither a theoretical nor a practical reason that Congress would have chosen to treat a first-time motion to convert a chapter 7 case to chapter 13 under subsection 706(a) differently from the filing of a chapter 13 petition in the first instance." Pet. App. 36.

Petitioner's position similarly creates anomalous results that Congress could not have intended, as it would accord preferential treatment to bad faith debtors who initially sought relief under chapter 7, instead of chapter 13. For instance, when confronted with a bad faith debtor who initially files under chapter 13, a court unquestionably has the power to dismiss or convert the case pursuant to Section 1307(c), without waiting for the debtor to file a plan. By contrast, in petitioner's view, a bad faith debtor who initially requests chapter 7 relief but subsequently seeks to convert to chapter 13 is entitled to file a chapter 13 plan without the possibility of intervention by the court to prevent an abuse of process, at least until a plan is filed. Petitioner's proposal is wholly implausible; it finds no support in the Code, and it would frustrate the underlying purpose of the bankruptcy court's power to sanction bad faith conduct, namely, to protect the integrity of the bankruptcy system and deter similar abuses by other debtors.

In any event, there is no guarantee that creditors will be protected once a bad faith debtor converts his case to chapter 13. A debtor who has tried to defraud his creditors in chapter 7 may not mend his ways just because his case converts to chapter 13, particularly because the chapter 7 trustee will have been replaced by a new chapter 13 trustee (who presumably will have less experience with the debtor's past misconduct) and the debtor will have gained control over the assets of the estate. See, *e.g.*, *In re Copper*, 426 F.3d at 810-816 (debtor lied about assets and, on the eve of trial in which divorce-decree debt would be determined to be non-dischargeable, moved to convert with no intent to pay ex-wife under chapter 13); *In re Sully*, 223 B.R. 582, 583-586 (Bankr. M.D. Fla. 1998) (debtor hid settlement of personal injury action from trustee, and once misconduct was discovered, debtor moved to convert under chapter 13 with no intent to pay creditors); *Martin* v. *Cox*, 213 B.R. 571, 572-574 (E.D. Ark. 1996) (debtor who, *inter alia*, falsified documents, failed to list significant assets in petition, made false representations to bankruptcy court, and violated a bankruptcy court's preliminary injunction order attempted to convert to chapter 13 with no intent to propose chapter 13 plan), aff'd, 116 F.3d 480 (8th Cir. 1997) (Table). Indeed, it has been the experience of the United States Trustees that bad faith debtors who convert to chapter 13 on the heels of the chapter 7 trustee's discovery of concealed assets often never file a plan.

Requiring a court to respond to a debtor's bad faith only after the debtor has proposed a chapter 13 plan would thus shift to innocent creditors the risk that a chapter 13 plan will never be proposed or confirmed. And even if a plan is confirmed, there is no assurance

that the debtor, who has already once attempted to defraud his creditors, will make payments under the plan.

Similarly, there is no guarantee that creditors would be protected while the case languishes in chapter 13 or even if the case is ultimately converted back to chapter 7. When a chapter 7 case is converted to chapter 13, the chapter 7 trustee no longer has the power to collect and liquidate assets or administer the estate for the benefit of creditors. 11 U.S.C. 348(e). Instead, conversion to chapter 13 permits the debtor to regain control of all estate assets. 11 U.S.C. 1306(b). Petitioner's proposal would thus unjustifiably open the door for bad faith debtors to mishandle or squander their assets in furtherance of a scheme to defraud creditors. See, *e.g.*, *In re Wampler*, 302 B.R. 601, 606 (Bankr. S.D. Ind. 2003) (after trustee learned of debtor's recovery of class action settlement, debtor refused to turn over recovery, sought conversion to chapter 13, and placed a large portion of the recovery "in a Certificate of Deposit, thereby diminishing its immediate value due to the penalty for earlier withdrawal"); *In re Sully*, 223 B.R. at 585 ("Conversion would afford the Debtor the use of the settlement funds, and shift the risk to creditors without any feasible likelihood of repayment."); *In re Calder*, 93 B.R. 739, 740 (Bankr. D. Utah 1988) (denying conversion to "prevent the debtor from further abuse of the system").

Finally, an approach that would require a court to wait for a chapter 13 plan to be filed before responding to the debtor's bad faith is even less justified for cases governed by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23. For bankruptcy cases filed after October 17, 2005, the bankruptcy court may confirm a chapter 13

plan only if "the action of the debtor in filing the petition was in good faith." § 102(g)(3), 119 Stat. 33 (to be codified at 11 U.S.C. 1325(a)(7)). Although petitioner's case was filed in 2003, before those changes became effective, the regime advanced by petitioner and his amicus would require a bankruptcy court, when confronted with a bad faith debtor's request to convert to chapter 13, to convert and give the debtor the opportunity to file a plan that Congress has categorically determined cannot be confirmed. Nothing in Section 706(a) requires that bizarre result.

D. The Legislative History Of Section 706(a) Does Not Reveal A Congressional Intent To Displace A Court's Inherent Power To Deny Relief To A Bad Faith Debtor

Petitioner asserts (Br. 20-23) that the legislative history of Section 706(a) supports his view that chapter 7 debtors who proceed in bad faith are nonetheless entitled to convert to chapter 13. There is no warrant for petitioner's apparent assumption that statements in congressional committee reports could suffice to override the inherent authority of the federal courts. As discussed, this Court will not "lightly assume" that Congress has limited or narrowed the scope of the inherent power. *Chambers*, 501 U.S. at 47. In any event, petitioner's interpretation of the legislative history is without merit.

1. The history of Section 706(a) contains no hint that Congress intended to require conversion when sought by a debtor acting in bad faith. The Senate Committee report accompanying Section 706(a) states:

> Subsection (a) of this section gives the debtor the one-time absolute right of conversion of a liquidation case to a reorganization or individual repayment plan

> case. If the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have that right. The policy of the provision is that the debtor should always be given the opportunity to repay his debts, and a waiver of the right to convert a case is unenforceable.

S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978); accord H.R. Rep. No. 595, 95th Cong., 1st Sess. 380 (1977). Placing emphasis on the words "absolute" and "always" in that passage, petitioner and his amicus argue that Congress intended to render bankruptcy courts powerless to deny a bad faith debtor's attempt to convert a chapter 7 case to another chapter. Pet. Br. 19-23; NACBA Amicus Br. 20-22.

Petitioner and his amicus make the mistake of reading the legislative history as if it were statutory text. But a Senate Report is not written, and should not be read, in that fashion. The Senate Report attempts to explain the operation of Section 706(a), and in doing so makes an off-hand reference to an "absolute right." Whatever the meaning of that phrase were it included in the operative statutory text, it is clear from context that the phrase reflects an effort to explain the text's right to file a conversion motion free from any time bar, so long as the case has not previously been converted. That reading is consistent with the sentencing following the reference to the debtor's "one-time absolute right," as that sentence makes clear that "[i]f the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have that right." S. Rep. No. 989, *supra*, at 94. As the court of appeals observed, the reference to the debtor's "absolute" right may also be

referring to the fact that "the debtor's right to conversion cannot be waived by contract." Pet. App. 37.

Under any reading of the Code, moreover, the Report's reference to an "absolute" right cannot be understood in the all-encompassing sense urged by petitioner, because conversion is expressly *prohibited*—and the right thus inoperative—when the debtor is not qualified to be a debtor under the other chapter. 11 U.S.C. 706(d). Nor is it literally true, as petitioner's reading of the Report suggests, that debtors "always" have the opportunity to repay their debts under chapter 13: Section 1307(c) permits the court to dismiss or convert a chapter 13 case for cause, and thus a *bad faith* debtor has no right whatsoever to repay his debts under chapter 13.

In any event, Section 706(a)'s legislative history does not mention, much less purport to remove, a court's inherent power to sanction and deter abuses of the bankruptcy system. There is no suggestion in the quoted passage above that Congress was addressing a *dishonest* debtor who was trying to defraud his creditors with no intention of repaying his debts. To the contrary, the passage is obviously referring to the *honest* debtor, as the overarching intent of Section 706(a) is to confer rights on a debtor who actually intends "*to repay his debts*." S. Rep. No. 989, *supra*, at 94 (emphasis added). But "[w]here conversion to [chapter] 13 amounts to an attempt to escape debts rather than to repay them, the reason for the rule ceases." *In re Spencer*, 137 B.R. 506, 512 (Bankr. N.D. Okla. 1992).

As the court of appeals correctly concluded, "[a] legislative policy aimed at encouraging able debtors to undertake the voluntary repayment of their lawful credit

obligations plainly is not served where the bankruptcy court has determined, as a threshold finding of fact, that the debtor is utilizing his subsection 706(a) conversion rights to advance an ongoing scheme to retain his non-exempt assets from bona fide creditors." Pet. App. 39; see *In re Wampler*, 302 B.R. at 605 ("[T]he statute was intended to give only the *honest* debtor an opportunity to voluntarily repay his debts * * *. Section 706(a) was not intended as a way for the dishonest debtor to abuse the bankruptcy process, perpetrate a fraud or engage in bad faith behavior."). Section 706(a)'s legislative history thus provides no support for stripping bankruptcy courts of their power to prevent an abuse of process or to sanction and deter bad faith conduct.

E. A Bankruptcy Court Properly Exercises Its Inherent Power When It Denies Conversion Of A Chapter 7 Case Based On The Debtor's Bad Faith

1. A bankruptcy court acts within its discretion in denying a debtor's request to convert to another chapter when the debtor intentionally misrepresents his financial condition in the bankruptcy proceeding. Such misconduct constitutes an egregious abuse of the bankruptcy system, which has always limited relief to the "*honest* but unfortunate" debtor. *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244-245 (1934) (emphasis added). "[T]he successful functioning of the bankruptcy act hinges both upon the bankrupt's veracity and his willingness to make a full disclosure" of his assets and financial condition. Pet. App. 33 (quoting *Boroff* v. *Tully (In re Tully)*, 818 F.2d 106, 110 (1st Cir. 1987)); *In re Little*, 245 B.R. 351, 353-354 (Bankr. E.D. Mo. 2000) ("Perhaps to a greater degree than any other segment of our justice system, Bankruptcy depends on the integ-

rity of the information supplied by its principal participant, the debtor.").

The importance of honest and full disclosure of a debtor's assets is particularly acute in cases filed under chapter 7. That chapter generally grants the debtor a complete discharge of his pre-petition debts. 11 U.S.C. 727. But the Code explicitly conditions such relief on the debtor's release to creditors of *all* his pre-petition and non-exempt assets. 11 U.S.C. 725, 726, 727(a). A debtor who files under chapter 7 thus has an incentive to try to conceal assets to obtain the benefit of relief from all of his debts while shielding assets from the prospect of liquidation. Such efforts strike at the structural foundation upon which chapter 7 is premised. Accordingly, a court may properly deny conversion relief to chapter 7 debtors either to prevent further abuse of process or to sanction and deter similar misconduct.

Petitioner contends that permitting courts to respond to debtor's bad faith would not be administrable or provide debtors fair notice of what conduct is permissible because "[w]hat constitutes 'extreme circumstances' is not 'capable of pragmatic and mechanical application.'" Pet. Br. 17 (quoting *In re Noll*, 172 B.R. 122, 124 (Bankr. M.D. Fla. 1994)). The bankruptcy court's power under Section 105(a) to act in the face of abuse of process, however, puts debtors on clear notice that the court has discretion to take appropriate action when confronted with misconduct. Section 105(a) likewise necessarily recognizes that bankruptcy courts are fully competent to determine whether a litigant is engaging in an abuse of process. In any event, petitioner has no plausible claim that debtors are unaware of their obligation of complete candor and disclosure in their state-

ment of financial affairs and schedule of assets, as those obligations are expressly set forth in the Code and Rules. 11 U.S.C. 521; Fed. R. Bankr. P. 1008 (requiring "[a]ll petitions, lists, schedules, statements and amendments thereto" to be verified or supported by a declaration under penalty of perjury pursuant to 28 U.S.C. 1746).

"Bad faith," moreover, is a familiar concept in the law, and bankruptcy courts routinely consider whether a debtor's conduct constitutes bad faith in the course of assessing the existence of "cause" for dismissal or conversion to chapter 7 under 11 U.S.C. 1307(c). See p. 17 & n.4, *supra*; see 11 U.S.C. 707(a) (authorizing dismissal for cause); 11 U.S.C. 1112(b) (authorizing dismissal or conversion to chapter 7 for cause); 11 U.S.C. 1208(c) (authorizing dismissal for cause). Thus, the bankruptcy courts that have denied conversion relief under Section 706(a) for bad faith have adopted a standard that is substantially similar to the standard applied in determining whether a debtor's bad faith warrants dismissal or conversion to chapter 7 under Section 1307(c). As the court of appeals observed, courts generally consider "the totality of the circumstances," including such factors as "the accuracy of the debtor's financial statements," "any other attempts by the debtor to mislead the bankruptcy court or manipulate the bankruptcy process," and "the debtor's motivation in seeking to convert to chapter 13." Pet. App. 41.

2. The bankruptcy court here properly exercised its discretion to deny conversion of petitioner's case to chapter 13 because of petitioner's bad faith in filing his chapter 7 case. As the court of appeals observed, "[t]he instant case comports in all material respects with the

classic profile of playing fast and loose with the bankruptcy process." Pet. App. 42. Before filing for bankruptcy relief, petitioner transferred valuable property in an acknowledged attempt to shield it from his creditors, and he failed to disclose the transfer in filing for bankruptcy. While petitioner was prepared to face liquidation of the estate absent the fraudulently concealed assets, when the trustee discovered the non-disclosure and initiated steps to reclaim the property for the benefit of creditors, petitioner sought to convert the case to chapter 13, presumably not only to oust the chapter 7 trustee, but also to retain petitioner's interest in the concealed property and shield it from liquidation. *Ibid.*[5]

In refusing to transfer the case from chapter 7, the bankruptcy court properly sanctioned the debtor for his misconduct while preserving the interests of creditors. Because the case remained in chapter 7, the chapter 7 trustee was able to recover petitioner's Maine property and liquidate it for the benefit of creditors. *Marrama*, 316 B.R. at 421-423. In addition, based upon a finding that petitioner intended to defraud his creditors, petitioner was denied a discharge of his debts under

[5] Petitioner challenges the bankruptcy court's factual finding that he acted in bad faith and the court's failure to conduct an evidentiary hearing. Pet. Br. 11, 22, 24. Both the bankruptcy appellate panel and the court of appeals rejected those contentions, Pet. App. 25-27, 41-44, and the petition did not seek this Court's review of those factbound issues. Pet. i. Moreover, as a result of subsequent proceedings in petitioner's chapter 7 case the court of appeals held that petitioner "transferred valuable assets belonging to him, less than a year before he petitioned for bankruptcy protection, with the actual intent to defraud his creditors." *Marrama* v. *Citizens Bank (In re Marrama)*, 445 F.3d 518, 524 (1st Cir. 2006). It does not appear that petitioner sought further review of that decision, which is now final, so he is precluded from challenging that factual determination.

11 U.S.C. 727. *Marrama* v. *Citizens Bank (In re Marrama)*, 445 F.3d 518 (1st Cir. 2006).

Denial of a chapter 7 discharge thus enabled petitioner's creditors to obtain estate assets under 11 U.S.C. 726, as well as to pursue any outstanding claims against petitioner post-bankruptcy. By contrast, converting the case to chapter 13 to permit petitioner to propose a plan would expose petitioner's creditors to the possibility of further abuse of the bankruptcy process, and would inevitably delay the proper disposition of the case. See pp. 20-22, *supra*. The bankruptcy court's denial of conversion to chapter 13 thus protected the rights of petitioner's innocent creditors and enabled the court to ensure the integrity of the bankruptcy process, in keeping with the core purposes of the court's inherent authority.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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